

Message Text

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ACTION NEA-12

INFO OCT-01 ADP-00 AID-20 EB-11 NSC-10 RSC-01 CIEP-02

TRSE-00 SS-15 STR-08 OMB-01 CEA-02 CIAE-00 COME-00

FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06 SIL-01

L-03 H-02 DODE-00 PA-03 USIA-12 PRS-01 IO-13 IGA-02

AGR-20 RSR-01 /178 W

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R 05 1530Z JUL 73

FM AMEMBASSY NEW DELHI

TO SECSTATE WASHDC 5372

INFO AMEMBASSY DACCA

AMEMBASSY ISLAMABAD

AMEMBASSY KATHMANDU

AMCONSUL BOMBAY

AMCONSUL CALCUTTA

AMCONSUL MADRAS

C O N F I D E N T I A L SECTION 1 OF 2 NEW DELHI 7839

DEPT PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: GDS

TAGS: EFIN, IN

SUBJ: INFLATION IN INDIA

REF: NEW DELHI 6378

BEGIN SUMMARY. THE GOI HAS RECENTLY AWAKENED TO THE SERIOUS INFLATIONARY SITUATION IN INDIA. THE IFY 1972/73 BUDGET DEFICIT WAS RECENTLY REVISED UPWARD TO RS. 8.48 BILLION AND THE PROJECTED DEFICIT FOR IFY 1973/74 IS PRESENTLY ESTIMATED BY EMBASSY AT RS. 4.47 BILLION. THE GOI IS PRESENTLY ENDEAVORING TO PARE GOVERNMENT EXPENDITURES, BUT IN VIEW OF LIKELY FURTHER EXPENDITURE FOR DROUGHT RELIEF AND FOOD PROCUREMENT ITS EFFORTS MAY NOT BE SUCCESSFUL. IF THE GOI
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IS NOT WILLING AND ABLE TO UNDERTAKE SIGNIFICANTLY TIGHTER FISCAL DISCIPLINE INDIA WILL BE IN FOR ANOTHER YEAR OF UNPRECEDENTED INFLATION.

END SUMMARY.

1. THE GOI AND THE INDIAN PRESS HAVE IN THE PAST COUPLE OF WEEKS AWAKENED TO THE SERIOUS CURRENT INFLATIONARY SITUATION IN INDIA BROUGHT ABOUT BY MORE THAN TWO YEARS OF UNDISCIPLINED GOVERNMENT SPENDING AND BY REDUCED AGRICULTURAL OUTPUT RESULTING FROM THE POOR 1972 MONSOON. WHOLESALE PRICES ARE CURRENTLY RISING AT AN ANNUAL RATE OF 20 PERCENT (THEY ROSE BY 5.8 PERCENT IN THE TWELVE MONTHS ENDING MARCH 31, 1972 AND BY 14.3 PERCENT IN THE TWELVE MONTHS ENDING MARCH 31, 1973), WITH WHOLESALE PRICES FOR FOOD ARTICLES RUNNING 24 PERCENT ABOVE YEAR-AGO LEVELS. THE MONEY SUPPLY IS CURRENTLY 14.6 PERCENT LARGER THAN IT WAS A YEAR AGO. IN ADDITION, THE GOVERNMENT RECENTLY ACKNOWLEDGED THAT THE BUDGET DEFICIT FOR IFY 1972/73 ACTUALLY TOTALLED RS. 8.48 BILLION (DOLS 1.1 BILLION) INSTEAD OF THE RS. 5.50 BILLION WHICH HAD BEEN ESTIMATED AT THE END OF FEBRUARY. THIS IS 9.1 PERCENT OF THE INDIAN MONEY SUPPLY.

2. THE SUBSTANTIAL INCREASE IN THE IFY 1972/73 DEFICIT WAS DUE TO A COMBINATION OF FACTORS. CURRENT RECEIPTS, PARTICULARLY EXCISE DUTIES, TURNED OUT TO BE LOWER THAN EXPECTED. EXPENDITURES, ON THE OTHER HAND, WERE FAR LARGER. THE MAJOR FACTORS INCREASING EXPENDITURES WERE ADDITIONAL OUTLAYS FOR RELIEF AND WELFARE PROGRAMS IN DROUGHT STRICKEN AREAS, LARGER DEFENSE SPENDING, AND ADDITIONAL CREDITS TO THE FOOD COOPERATION OF INDIA TO FINANCE DOMESTIC GRAIN PROCUREMENT PLUS IMPORTS FROM ABROAD.

3. THE 1972/73 DEFICIT WAS FINANCED MAINLY BY AN INCREASE OF RS. 8.00 BILLION IN TREASURY BILLS OUTSTANDING, AND WAS THE PRINCIPAL CAUSE OF THE 14 PERCENT INCREASE IN THE INDIAN MONEY SUPPLY LAST YEAR. DURING THIS PERIOD, AND ALSO DURING THE PREVIOUS INDIAN FISCAL YEAR, REAL NATIONAL INCOME INCREASED BY LESS THAN 2 PERCENT. THESE FACTORS, COMBINED WITH AN ADVERSE FOOD SITUATION RESULTING FROM A SEVERE DROUGHT IN SEVERAL INDIAN STATES LAST SUMMER CAUSED

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SEVERE PRESSURE ON PRICES, ESPECIALLY FROM THE SUMMER OF 1972 ONWARDS.

4. EVEN THE RS. 8.48 BILLION FIGURE UNDERSTATES THE REAL IMPACT OF RECENT GOVERNMENT SPENDING ON THE ECONOMY. A BETTER MEASURE OF THIS IMPACT IS NET BANK CREDIT TO THE GOVERNMENT SECTOR, INCLUDING CREDIT TO STATE GOVERNMENTS, WHICH

INCREASED BY RS. 12.91 BILLION (DOLS 1.7 BILLION) IN IFY 1972/73. THIS INCREASE WAS 13.9 PERCENT OF THE INDIAN MONEY SUPPLY, AND MORE THAN ACCOUNTS FOR THE INCREASE OF RS. 11.37 BILLION IN THE MONEY SUPPLY LAST YEAR.

5. IN VIEW OF THE CONTINUED PRESSURE ON PRICES, THE IFY 1973/74 BUDGET SUBMITTED TO THE PARLIAMENT ON FEBRUARY 28, 1973 CALLED FOR A MUCH REDUCED CENTRAL GOVERNMENT DEFICIT OF RS. 850 MILLION. IN VIEW OF THE RAPID MONETIZATION OF THE INDIAN ECONOMY, THE GOVERNMENT CLAIMED THAT THIS WOULD HAVE A RESTRAINING EFFECT ON THE INCREASE IN PRICES. THE CENTRAL GOVERNMENT EXPRESSED THE HOPE THAT THE STATE GOVERNMENTS WOULD IMPROVE FISCAL DISCIPLINE.

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C O N F I D E N T I A L SECTION 2 OF 2 NEW DELHI 7839

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6. ANTICIPATED STATE GOVERNMENT DEFICITS FOR 1973/74, HOWEVER, TOTALLED RS. 1.80 BILLION. THESE LARGE DEFICIT ESTIMATES WERE CALCULATED TO INFLUENCE THE FINANCE COMMISSION, WHICH IS CURRENTLY DELIBERATING, TO RECOMMEND LARGER TRANSFERS OF RESOURCES FROM THE CENTER TO THE STATES. INCLUDING THE STATES' DEFICITS, THE TOTAL PROJECTED DEFICIT FOR IFY 1973/74 AMOUNTED TO RS. 2.65 BILLION.

7. BECAUSE OF DEVELOPMENTS SINCE THE PRESENTATION OF THE BUDGET IN FEBRUARY, THE IFY 1973/74 DEFICIT IS NOW EXPECTED
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TO BE MUCH LARGER THAN RS. 2.65 BILLION. THE RECOMMENDATIONS OF THE THIRD PAY COMMISSION, WHEN IMPLEMENTED, ARE EXPECTED TO INVOLVE AN ADDITIONAL EXPENDITURE OF RS. 1.50 BILLION. INCREASES IN GOVERNMENT DEARNESS (COST OF LIVING) ALLOWANCES TO GOI EMPLOYEES ARE ESTIMATED TO COST AN ADDITIONAL RS. 300 MILLION. TAX CONCESSIONS MADE BY THE MINISTRY OF FINANCE AFTER THE INITIAL BUDGET PRESENTATION WILL CUT REVENUE BY AN ESTIMATED RS. 20 MILLION. THE EFFECT OF THESE FACTORS IS TO INCREASE OVERALL DEFICIT TO RS. 4.47 BILLION (DOLS 600 MILLION).

8. TO REDUCE THE IMPACT OF GOVERNMENT SPENDING ON INFLATION, THE MINISTRY OF FINANCE HAS RECENTLY ASKED ALL MINISTRIES TO PARE EXPENDITURES NOT INCLUDED IN THE LAST YEAR OF THE CURRENT FIVE-YEAR PLAN BY 5 PERCENT. SINCE IT IS NOT LIKELY THAT THESE EXPENDITURES, IF CARRIED OUT, WOULD BE AT THE EXPENSE OF GOVERNMENT DIRECT EMPLOYMENT, SOME PROGRAM EXPENDITURES OF THESE MINISTRIES ARE LIKELY TO SUFFER BY SUBSTANTIALLY MORE THAN 5 PERCENT. SOME MINISTRY OF HEALTH PROGRAMS ARE REPORTEDLY BEING CUT BACK AS MUCH AS 40 PERCENT. IN ADDITION, A REDUCTION IN FIVE-YEAR PLAN EXPENDITURES FOR IFY 1973/74 OF RS. 2.50 BILLION, OR 6 PERCENT, IS ALSO REPORTEDLY UNDER CONSIDERATION. AS A "TIMES OF INDIA" EDITORIAL OF JULY 2, 1973 NOTED: "THE UNION FINANCE MINISTRY AND THE PLANNING COMMISSION SEEM TO HAVE SUDDENLY WOKEN UP TO THE NEED FOR DRASTIC ECONOMIES TO HALT THE RUN-AWAY INFLATION."

9. EVEN IF IT IS ASSUMED THAT THE GOI SUCCEEDS IN RESISTING PRESSURES AGAINST THESE CUTS, IT MAY NOT BE ABLE TO RESIST THE DEMAND FOR ADDITIONAL EXPENDITURES IN OTHER AREAS SUCH AS RELIEF AND WELFARE MEASURES NECESSITATED BY DROUGHT IN CERTAIN AREAS AND ADDITIONAL EXPENDITURE FOR FOOD SUBSIDIES CAUSED BY RECENTLY ANNOUNCED HIGHER PROCUREMENT PRICES OF RICE AND INDIRECT SUBSIDIES TO THE STATES

FOR WHEAT PROCUREMENT. A PROPOSAL TO INCREASE THE SELLING PRICE OF FOODGRAINS TO CONSUMERS IS UNDER CONSIDERATION TO REDUCE THE INCREASED FOOD SUBSIDY EXPENDITURES. THIS, HOWEVER, WOULD LEAD TO HIGHER CONSUMER PRICES FOR FOOD AND MERELY TRADES ONE CAUSE OF INFLATION FOR ANOTHER.

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10. THE GOVERNMENT'S ABILITY TO SUCCEED IN REDUCING ITS BUDGET DEFICIT AND DAMPENING PRICE INCREASES IN IFY 1973-74 IS PROBLEMATIC. UNLESS THE GOI IS PREPARED AND ABLE TO UNDERTAKE A MASSIVE BELT-TIGHTENING AND TO GO SUBSTANTIALLY FURTHER IN IMPOSING FISCAL DISCIPLINE OVER ITSELF AND IN INCREASING THE COST OF BANK CREDIT, INDIA MAY WELL BE IN FOR ANOTHER YEAR OF UNPRECEDENTED INFLATION -- PERHAPS EVEN MORE RAPID THAN IN THE RECENT PAST. A BAD 1973 MONSOON WILL GREATLY AGGRAVATE THIS SITUATION, AND A GOOD MONSOON PROBABLY WILL NOT SLOW INFLATION MUCH.
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